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Supreme Court, U. S.
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In the Supreme Court of the United States

October Term, 1972

No. 73-32

FINANCIAL INDUSTRIAL FUND, INC.,
Petitioner,

v.

McDONNELL DOUGLAS CORPORATION,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Tenth Circuit (App. E to petition) is reported at 474 F.2d 514. The opinion of the United States District Court for the District of Colorado denying respondent's motion for summary judgment (App. A to petition) is reported at 315 F.Supp. 42. The opinion of the District Court denying motions for judgment notwithstanding the verdict and for new trial is not officially reported, but is set out in Appendix D to the petition and has been reported at CCH Fed. Sec. Law Rptr. ¶ 93,004.

JURISDICTION

The opinion of the Court of Appeals was entered on February 20, 1973, and the petition for rehearing was denied on April 5, 1973. Petitioner seeks to invoke the jurisdiction of this Court under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

Where the petitioner (plaintiff below) purchased 80,000 shares of respondent's stock in the open market in the face of public information that earnings of respondent would be adversely affected by delays in aircraft manufacture and further public information that respondent had had no earnings for the most recent two months; where petitioner's purchase had been triggered by a press release issued by an airline describing an additional order for respondent's aircraft yet to be manufactured, and where respondent had resorted to and was exercising reasonable and prudent steps to assure that proper and accurate earnings figures reflecting additional items just coming to its attention would be promptly released to the public and financial community, was the decision of the court below correct:

1. When it ruled, under these facts, that the petitioner was not entitled to recovery;

2. When it held that respondent had no duty to the investing public to disclose varying and tentative preliminary estimates of quarterly and semi-annual earnings before the earnings figures and the proper accounting treatment with respect thereto were finally determined;

3. When it found that petitioner, having purchased the stock despite substantial unfavorable information known to petitioner, without the benefit of substantial investment analysis of which it was capable, and more than two weeks before the release of respondent's quarterly and semi-annual earnings was anticipated, was foreclosed from recovery based on the alleged failure of respondent to more hastily issue additional unfavorable earnings information.

4. In holding that respondent's prompt and diligent activity to ascertain the hard facts before releasing quarterly and semi-annual earnings figures to the public was a matter

within its discretion and responsibility for which no liability would result under S.E.C. Rule 10b-5 so long as that discretion was not abused?

CONSTITUTIONAL PROVISIONS, STATUTES AND RULES INVOLVED

In addition to the authorities cited by petitioner, also applicable herein is Rule 50, Federal Rules of Civil Procedure.

ADDITIONAL STATEMENT OF THE CASE

Respondent is the successor by merger in 1967 of Douglas Aircraft Company ("Douglas") and the McDonnell Company. We believe the opinion of the Court of Appeals en banc fairly states the important and operative facts. (Petition, App. E, pp. 40a-43a, 47a-51a).

Petitioner's statement of the case is selective and argumentative. In the interest of brevity, we do not set out here all of the facts we deem important and which petitioner has ignored or characterized in argumentative fashion. We do, however, point out certain facts and matters we believe merit highlighting here.

First, and of importance to whether this Court should grant the writ, is that the facts involve what occurred within a limited time applicable only to Douglas and involving only its operations, expectations, investigations and revelations.

This action arose from the purchase by petitioner Financial Industrial Fund, a registered open-end investment company, of 80,000 shares of common stock of Douglas in the open market on June 22 and 23, 1966. (R. Vol. IX, p. 7). On June 24, 1966, before the opening of the stock for trading, there was disseminated a concededly accurate press release stating that Douglas' earnings for the six months ending May 31, 1966, were 12 cents per share. (R. Exh. D-3, Vol. XI, pp. 942-43; Vol. I, p. 110). The price of Douglas stock subsequently declined, and petitioner liquidated its holding of this stock. (R. Vol. I, p. 114).

Petitioner's basic contention below centered around the fact that Douglas had not disseminated the 12 cents per share earnings figure before June 24th, while respondent contended Douglas had exercised due diligence and good faith in ascertaining, verifying and disseminating the earnings figure before release to the news media and the public. Prior to that time, the tentative and fluctuating earnings estimates were not ripe for publication.

It was undisputed below that prior to its purchase, petitioner neither had any contact with nor attempted to contact Douglas concerning either its actual or anticipated earnings (R. Vol. II, p. 158), and that petitioner's purchase was "triggered" (R. Vol. II, p. 186) by a true announcement by United Air Lines on June 21st that it was purchasing $220 million worth of Douglas DC-8 and DC-9 aircraft. (R. Vol. XI, p. 1003; Vol. I, p. 91; Vol. II, p. 191).

There was no proof of any insider trading by Douglas, nor was there any proof that Douglas stood to gain or did gain from any delay in releasing the earnings figure, or that Douglas "leaked" any information regarding earnings. (R. Vol. VII, p. 994).

REASONS WHY THE WRIT SHOULD BE DENIED

The decision of the Court of Appeals was correct and was in accord with applicable decisions of this Court and the courts of appeal. The true basis for petitioner's claim here is not that the decision of the Court of Appeals below is in direct conflict with any decision of this Court, or with that of any other court of appeals, but rather that in the particular factual circumstances involved in this case, petitioner believes the decision was incorrect. Of course, this Court does not sit simply as a court of errors and the dispute here does not raise the kind of question which makes this action worthy of the grant of certiorari.

1. The decision below does not conflict with the decision of this Court or of any court of appeal.

The ruling below by the United States Court of Appeals for the Tenth Circuit does not conflict with either the

decisions of this Court or the decisions of any court of appeal. For example, the very formulation of the rule of which plaintiff complains, that a duty to disclose arises only when the information which ought to be disclosed is "available and ripe for publication," had previously been adopted both in the Tenth Circuit in *Mitchell v. Texas Gulf Sulphur Co.*, 446 F.2d 90 (10th Cir. 1971), *cert. denied*, 404 U.S. 1004 (1971), and by the Second Circuit in *Securities and Exchange Commission v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied sub nom. Coates v. SEC*, 394 U.S. 976 (1969).

Petitioner is not able to point to a single case which calls for the adoption of or the adherence to a different standard. Instead, petitioner argues simply that the adoption of that standard, by these courts, undermines the statutory purpose of full disclosure in the securities industry. But the philosophy of full disclosure underlying the securities laws does not require the dissemination of tentative, unripe or possibly misleading information. That philosophy also does not convert companies whose securities are listed on national exchanges into insurers of investment decisions of the public.

Petitioner's suggestion also ignores two important policy considerations recognized by the Court of Appeals below. First, companies are managed by their boards of directors and their officers, and for sound economic and social reasons, the courts generally defer to the policy judgments of such managers unless the range of decision is clearly abused. The "business judgment" rule, recognized by statute or decision in all states, has long stood the test of time. Fletcher, *Cyclopedia of Corporations* (Perm. Ed.) § 1039. Courts do not sit to re-examine de novo such judgments made in good faith. They have shown, and must show, more restraint. A second important rule is that "hindsight" is not the gauge of possible liability, but that the actions complained of must be viewed through the lens of what defendant knew the situation to be at the time. *Financial Industrial Fund, Inc. v. McDonnell Douglas Corp.*, *supra* at 518.

When the full disclosure policy underlying the securities

laws comes into play in a case in which the business judgment and non-hindsight policies are also present, there is required a judicial accommodation between the wholesome policies underlying all three approaches.

Such an accommodation was achieved below, and in the Second Circuit. It should not be upset, or further reviewed, here, especially when petitioner has failed to come forth with a satisfactory alternative standard or proposed rule.

The standards set forth below are well-reasoned and need not be re-examined here:

> ". . . Rule 10b-5 is violated whenever assertions were made, as here, in a manner reasonably calculated to influence the investing public, e.g., by means of the financial media, [citation omitted], if such assertions are false or misleading or are so incomplete as to mislead irrespective of whether the issuance of the release was motivated by corporate officials for ulterior purposes. It seems clear, however, that if corporate management demonstrates that it was diligent in ascertaining that the information it published was the whole truth and that such diligently obtained information was disseminated in good faith, Rule 10b-5 would not have been violated." *Securities and Exchange Commission v. Texas Gulf Sulphur Co., supra* at 862.
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> ". . . the information about which the issues revolve must be 'available and ripe for publication' before there commences a duty to disclose. To be ripe under this requirement, the contents must be verified sufficiently to permit the officers and directors to have full confidence in their accuracy. It also means, as used by the Second Circuit, that there is no valid corporate purpose which dictates the information be not disclosed. As to the verification of the data aspect, the hazards which arise from an erroneous statement are apparent, especially when it has not been carefully prepared and tested. It is equally obvious that an undue delay not in good faith, and revealing facts, can be deceptive, misleading, or a device to fraud

under Rule 10b-5. *Financial Industrial Fund, Inc. v. McDonnell Douglas Corp., supra* at 519.

Petitioner has not advanced any legal standard other than that called for by the courts of appeal but simply suggests that had petitioner purchased the stock involved from respondent, respondent would have had a duty to postpone the transaction or disclose. Petitioner's suggestion ignores the fact that plaintiff did not contact or even attempt to contact respondent before its purchase, and that there was no inside trading here. Moreover respondent acted equivalently to postponing a face to face transaction—it acted to arrive at and verify the information before disseminating it to the public. The effect of taking petitioner's suggestion would require respondent to be held liable for taking the time (four days) to ascertain the proper accounting treatment and extent of the adjustments required by the recently-concluded quarterly review, and to issue its earnings statement. Surely the expenditure of such a limited amount of time for such a bona fide purpose cannot give rise to liability.

Had respondent disclosed on June 20th even the tentative information it knew then, there could have been actions brought by persons who purchased on June 17th. Had the respondent disclosed on the 17th, there could have been actions brought by persons who purchased on the 16th, and so on. Thus, whenever a determination is made by a company to disseminate information, there is always a party who may have purchased or sold in the market who can claim he would not have done so had the information been disclosed one or two days earlier. In addition, the Court of Appeals was clearly correct in noting that "the hazards which arise from an erroneous statement are apparent, especially when it has not been carefully prepared and tested." *Ibid.* We submit that the Court of Appeals was clearly correct in holding that where, as here, there is no evidence of bad faith or undue delay, a corporation cannot be held liable under Rule 10b-5 for securities fraud in connection with the dissemination of accurate information concerning its earnings, because it did not more hastily issue tentative information.

Moreover, petitioner has now, for the third time, changed its basic theory of the case—apparently in the hope that if two theories have not succeeded, a third theory may. Thus, in the Pre-Trial Order, the factual issues were formed in terms of alleged "tipping" by Douglas to Merrill Lynch and others in the June 17 – June 23 period. This emphasis was reiterated before trial, when in petitioner's memorandum opposing summary judgment, its counsel stated:

> "In this case it is unnecessary to consider whether defendants were required to release materially revised earnings information to the public prior to June 24, 1966. The important fact is that both or one of them chose to make non-public releases prior to June 24, 1966, and that if plaintiff had known of this, it would not have purchased Douglas stock." (R. Supp. Vol. IX, p. 14).

When the trial court ruled that "tipping" was not a viable theory, and that at trial that there was absolutely no evidence of tipping by Douglas (R. Vol. VII, p. 994), petitioner reversed its field and argued that the 12¢ earnings figure was the heart of the case. In rebuttal in closing argument, petitioner's counsel argued:

> "But, in any event, we ought to get around to what really is this case; what is the meat in the coconut here. It comes down strictly to a failure to disclose promptly to the public a basic material fact. And that is the actual earnings of the first six months of the 1966 fiscal year." (R. Vol. VIII, pp. 3-4).

Having been rebuffed by the Court of Appeals on this theory, after having been rebuffed by the trial court on its tipping theory, petitioner now stresses a long term manipulation theory. We respectfully submit that the alleged failure to disclose promptly was given full and adequate review below by the Court of Appeals en banc, and that there is no necessity for this Court to review the action again, either on that theory, or on a claimed manipulation theory or any other approach.

2. Even if the Court of Appeals had applied the incorrect legal standard to measure the timeliness of disclosure, this Court would still be required to affirm, and would not reach that issue, because of petitioner's demonstrated lack of due diligence before the purchase herein, or because causation of harm could not be demonstrated.

In this case, petitioner, a professional investor, showed a glaring lack of due diligence—even to the extent of ignoring financial estimates in its own files.

An officer of petitioner was asked point-blank what he relied upon to purchase, and he answered:

> "I relied basically on two facts: first, *continuing estimates of increases in the earnings of Douglas for 1966, and subsequent periods due to the large number of orders they were receiving*; and secondly, an increasing confidence that these earnings would be reflected in high price earnings multiples so that ultimately the price would be higher than the price we paid for it." (Emphasis supplied) (R. Vol. II, p. 137).

Yet, the increasing estimates for 1966 he purportedly relied on were proved not to exist. Brokers' reports in petitioner's own files established a *downward* trend:

Co. Making Analysis	Date of Report	Analysts' Estimate of Douglas 1966 Earnings
Baker Weeks	Jan. 4, 1966	$4.75
Hutton	Jan. 1966	4.50
Pressprich	Jan. 1966	4.25
Dean Witter	Jan. 12, 1966	4.00
Smithers	Jan. 18, 1966	4.50
J. Barth	Feb. 21, 1966	5.00
J. Barth	Feb. 1966	4.75
Dean Witter	Feb. 24, 1966	4.25
Goldman, Sachs	Mar. 14, 1966	4.00-4.50
Baker Weeks	Apr. 4, 1966	4.75
Sutro	Apr. 21, 1966	No estimate
Baker Weeks	Apr. 28, 1966	4.50
Donaldson, Lufkin	May, 1966	4.50-5.00
Bank of New York	May, 1966	4.15
Baker Weeks	May 19, 1966	4.00-4.25
Coleman	June 6, 1966	3.30-3.50
Baker Weeks	June 6, 1966	3.25-3.50
Baker Weeks	June 16, 1966 (R.Exhs. G-T, Vol. I, p. 71).	3.00

Merrill Lynch had reduced its earnings estimate but was not contacted. (R. Vol. IV, pp. 396-7). Respondent issued a bearish press release only three weeks before the purchase. (R. Exh. AM-37, Vol. XI, p. 884). Petitioner ignored the published lack of earnings for March and April, 1966 shown by the preliminary prospectus of June 7. (R. Exh.

R, Vol. XI, p. 997 (4); Vol. II, p. 170). Petitioner did not contact respondent before the purchase. (R. Vol. II, p. 158). Although petitioner intended to purchase a very large and substantial position in the stock, it failed to use an aerospace analyst it had recently hired to investigate and report on Douglas. (R. Vol. II, p. 160). Petitioner was aware that in 1966, before the purchase, the price of Douglas stock had ranged from 60 to 112 dollars per share. (R. Vol. I, p. 104).

Notwithstanding all these factors, despite the bearish report concerning Douglas which petitioner received on June 2, and despite the fact that it knew the effect of the United Airlines order announced on June 21 by United was simply to add to Douglas' huge backlog of $2.8 billion but would not add to earnings in fiscal year 1966 (R. Vol. II, p.179), petitioner proceeded on June 22 and 23 to purchase a $7 million position in Douglas stock. If there were ever a case of an investor failing to proceed with due diligence, this is that case. In *Mitchell*, *supra*, at 103, the Court of Appeals properly ruled that plaintiff Stout was barred from recovery by reason of ignoring information which was publicly available. A fortiori, when a professional investor ignores public information and data in its own files or fails to carefully carry through its own investigation, it should be barred from recovery.

Any reasonable man reviewing the lack of diligence exercised by petitioner had to conclude that the injury to it was caused by its own lack of care, rather than by acts or omissions of respondent.[1] The Court of Appeals properly so held.

Nor could the petitioner prove below that any breach of duty by respondent of which it complained caused it harm.

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[1] Petitioner apparently argues (petition 17) that the fact of its "sophistication" in the investment field does not relieve respondent of its alleged duty to disclose tentative estimates. Whether this be correct or not, the fact remains that *no one* should be permitted recovery when it chooses to ignore what it knew or should have known from facts within its files, records, or research data repository. *Clement A. Evans & Co., Inc. v. McAlpine*, 434 F.2d 100, 104 (5th Cir. 1970), *cert. denied sub nom. Clement A. Evans & Co., Inc. v. A. M. Kidder & Co.* 402 U.S. 988 (1971).

As the Court of Appeals noted, petitioner purchased by 9:15 a.m. (Denver time) (R. Vol. II, pp. 213-4) on June 22, 1966 the 57,000 shares as to which the jury rendered the verdict in its favor. Yet the meeting by Douglas with its accountants at which the inventory write-down was finally agreed upon was not concluded until after petitioner had completed these purchases. (R. Vol. IV, pp. 510-12). That meeting resulted in the 12¢ figure becoming firm, and that figure was publicly disseminated less than 48 hours later, before the opening of trading on June 24. Had respondent instantly made the information public, it would not and could not have prevented petitioner's purchase.

Moreover, petitioner's purchase on June 22 was triggered by the June 21 United Airlines story, which announced, in part, purchases by it of Douglas-manufactured aircraft. There was admittedly nothing untruthful in that story.

Thus, no action or inaction of Douglas could have been the cause in fact of any harm to petitioner, and the Court of Appeals ruled properly.[2]

3. The Court of Appeals correctly applied the proper legal standards in setting aside the jury verdict.

The Court of Appeals' ruling with respect to setting aside the jury's verdict is brief, and is quoted here:

> "Under the standards herein set out, the trial court should have granted the motion of defendant Douglas for judgment notwithstanding the verdict. *We have considered the evidence most favorably to the plaintiff, and have given it the benefit of all reasonable inferences which may be drawn from the evidence.* [Citations omitted]. In so doing we have separated the evidence relating to Merrill Lynch from that relating to Douglas. The evidence as to Douglas, as indicated above, shows the presence of a strong motive to delay the

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[2] Although the Court did not put its ruling in those terms, its holding of lack of reliance, 474 F.2d at 521, was a holding that the causation required for liability was not here present for the reasons stated above.

> publication of figures showing a decline in earnings, but *there is no proof that there was such a delay within the legal standard set forth above. There was speculation and innuendo, but no facts.* Thus under the standards heretofore set forth by this Court and herein described, the trial court should have granted defendant's motion for judgment n.o.v." (Emphasis supplied) 474 F.2d at 522.

In its opinion, the Court cited four prior opinions of the Tenth Circuit Court of Appeals. Each of those decisions sets forth legal standards consistent with the standards set forth by this Court.

The facts in this case were largely uncontroverted, and there was no showing that Douglas unreasonably delayed the dissemination of its earnings figures intentionally or otherwise.

It was also uncontroverted that petitioner purchased the stock on June 22, not on the basis of analysis by one of its research analysts, but rather because of an admittedly accurate newspaper story on June 21 which indicated that Douglas was the recipient of a sizeable order for aircraft which would not result in earnings for at least a year to 18 months.

Petitioner has failed to show why the Court's statement, cited by the petitioner at page 19, is incorrect. That statement is as follows:

> "... it is apparent that an earnings statement issued by a corporation at any but the expected time which shows any substantial change is bad news for someone who had been recently in or out of a fluctuating market."

But the Court did not limit its observations on the lack of petitioner's due diligence to that point. For example, the Court noted that petitioner was aware of a whole host of problems which plagued Douglas and that "plaintiff employed some 10 persons as stock analysts, but no report was received from them as to this purchase." 474 F.2d at 519.

As to the finding of motive to delay, such a finding of motive does not substitute for a finding that there occurred an actual delay. The Court of Appeals decision repeatedly stresses how promptly Douglas officials actually moved to ascertain the earnings information and disseminate it to the public. 474 F.2d at 516-517 and 520.

The Court of Appeals thus properly applied the correct standard in determining that there was no evidence sufficient to permit a reasonable man to conclude that each of the elements requisite to Rule 10b-5 liability had been established by the petitioner below and, therefore, requiring the jury verdict to be set aside.

CONCLUSION

Respondent respectfully submits that the petition for a writ of certiorari should be denied.

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